

Letter of Findings: 09-0765
Gross Retail Tax
For the Years 2006, 2007, and 2008

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ISSUES

I. Bulk Mailer Equipment – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c); Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988) [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-8](#)(d).

Taxpayer argues that its bulk mailing machine is part of an integrated process and exempt from sales/use tax.

II. Supplies – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c); [45 IAC 2.2-5-12](#)(a).

Taxpayer maintains that purchases of certain supplies and ink are exempt from sales/use tax.

III. Web Hosting – Gross Retail Tax.

Authority: IC § 6-2.5-4-1; IC § 6-8.1-5-1(c).

Taxpayer states that payments it makes for "web hosting" services are not subject to sales or use tax.

STATEMENT OF FACTS

Taxpayer is a full-service Indiana based commercial printing company. The Department of Revenue (Department) reviewed Taxpayer's records and assessed additional sales/use tax on certain items. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Bulk Mailer Equipment – Gross Retail Tax.

DISCUSSION

The Department's audit found that Taxpayer purchased a bulk mailing machine – an Imager IIIS-00 – without paying sales or use tax. The audit report stated that, "Taxpayer believes that the bulk mailing machine is an integral part of [Taxpayer's] manufacturing process because the machine, folds, tab seals, and prints address[es] on the printed product and... should not be subject to use tax."

The audit found that the bulk mailing machine was not exempt and assessed use tax. The Department did so under authority of [45 IAC 2.2-5-8](#) which states:

(a) In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.

(b) The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property.

(c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

Taxpayer purchased an Imager IIIS-00 and believes that the device is exempt stating that it is "an integral part of the entire manufacturing process, it tabs, seals and prints addresses on the product to be eventually mailed." Taxpayer states the device "alters the material to its final tabbed, sealed, and addressed form." In support of this conclusion and in addition to the regulation cited above, Taxpayer cites to [45 IAC 2.2-5-8](#)(d) which states as follows:

"Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

Based upon Taxpayer's description of its particular manufacturing process, original source material describing the manner in which the device functions, and copies of invoices stipulating what it is Taxpayer's customers are buying and what Taxpayer is selling, the Department is prepared to agree that Taxpayer has met its burden of demonstrating that the device is part of Taxpayer's "integrated production process...."

FINDING

Taxpayer's protest is sustained.

II. Supplies – Gross Retail Tax.

DISCUSSION

Taxpayer argues that its purchases of supplies such as ink are exempt. Without stating as much, Taxpayer presumably relies on [45 IAC 2.2-5-12\(a\)](#) which states as follows:

The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.

Taxpayer indicates that "Supplies for equipment" are exempt and claims that the \$6,235 it paid for these "supplies" is not subject to tax.

As noted in Part I above, IC § 6-8.1-5-1(c) requires that the Taxpayer prove that the proposed assessment is wrong. In the case of the \$6,235 in supplies, Taxpayer's casual observation that they are exempt is insufficient to establish how or in what manner the supplies are used. In the absence of more detailed information, the Department is unable to agree that Taxpayer is entitled to the exemption.

FINDING

Taxpayer's protest respectfully denied.

III. Web Hosting – Gross Retail Tax.

Taxpayer asks for a "correction that was missed by the auditor...." Taxpayer explains that it "offers web hosting to its clients." As part of that service, Taxpayer states that it "pays a monthly service fee to internet search engines that enable the clients' web site to be listed in primary spots when an internet search is performed."

Taxpayer explains that it pays for "Google Adwords" and for "Function Fox Systems." Taxpayer believes that \$4,555 it pays for these two items is not subject to sales tax.

Without stating as much, Taxpayer presumably believes that the \$4,555 in payments does not constitute a "retail transaction" under IC § 6-2.5-4-1 and that "Google Adwords" and "Function Fox" simply provide an exempt service. However, as in Part II above, Taxpayer has provided nothing to explain the basis for its argument or that the payments represent an exempt transaction. Without more, under IC § 6-8.1-5-1(c), and in the absence of more detailed information, the Department is unable to agree that Taxpayer is entitled to the exemption.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

Taxpayer's purchase of the Imager IIIS-00 is not subject to sales or use tax; in all other respects, Taxpayer's protest is denied.

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